Air Resources Board

Linda S. Adams
Secretary for Environmental Protection

Robert F. Sawyer, Ph.D., Chair
1001 I Street • P.O. Box 2815
Sacramento, California 95812 • www.arb.ca.gov

Arnold Schwarzenegger
Governor

May 30, 2007

Ms. Shana Lazerow
Communities for a Better Environment
1440 Broadway Suite 701
Oakland, California 94612

Mr. Tim Grabiel
Natural Resources Defense Council
1314 Second Street
Santa Monica, California 90401

Ms. Angela Johnson Meszaros
California Communities Against Toxics
1107 Fair Oaks #246
South Pasadena, California 91030

Dear Colleagues:

The Office of Legal Affairs of the Air Resources Board (ARB or Board) has completed its review of your petition, dated October 6, 2006 requesting that ARB conduct a public hearing to determine whether certain September 8, 2006 actions by the South Coast Air Quality Management District (SCAQMD or District) adopting Rule 1315, Federal New Source Review Tracking System, and amending Rule 1309.1, Priority Reserve, constitute an impermissible weakening of its new source review (NSR) rules. Amendments to NSR rules that make them less stringent than the rule as it existing on December 30, 2002, are generally prohibited by Senate Bill (SB) 288, (Stats 2003 ch 476, Sher), the Protect California Air Act of 2003, which enacted Health and Safety Code (HSC) sections 42500-42507.

As enacted by SB 288, HSC section 42504(a) establishes a mechanism under which ARB may conduct a hearing to review whether a district's amendments to its NSR rule meet SB 288 criteria. There are no provisions for petitions requesting ARB to conduct a HSC section 42504(a) hearing to review a district's NSR rule amendments. As discussed below, I have concluded that the challenged amendments do not violate SB 288 as a matter of law and therefore do not trigger a need for an ARB hearing. If such a hearing were to be conducted, based on the information we have received I would advise the Board of my opinion that as a matter of law the amendments do not weaken The District's NSR rule. Nevertheless, if you wish we are prepared in this

particular instance to schedule a hearing by our Board at which you could present the basis for your position that the Board should find that adoption of the amendments violated SB 288.

The Challenged District Rule Revisions

Under the District's NSR program as it existed December 30, 2002, an entity wishing to construct a new major source or to make a major modification to an existing source had to offset all new emissions from the source by new or prior emission reductions from other sources in the area. While most offsets in the District were acquired in the public market, the District also maintained internal accounts of emissions reduction credits (ERCs) that could be used in particular instances. One of these accounts, called the Priority Reserve, was designed to ensure that ERCs were always available for constructing or expanding essential public services such as power plants. The District's NSR rules are contained in Regulation XIII.

On September 8, 2006, the District's Governing Board made two changes to its NSR regulation – it adopted new Rule 1315 and amended Rule 1309.1. You assert that both of these actions constituted violations of SB 288.

Rule 1315, New Source Review Tracking System. This new rule formalized the federally-required accounting mechanism that tracks ERCs in the District's internal accounts. This mechanism comes into play when sources subject to federal NSR emission requirements seek to use ERCs obtained through allocations from the Priority Reserve account or use the emission offset exemption applicable to specified minor sources. The object of the accounting mechanism is to ensure that emissions increases from these sources are fully offset by emissions reductions meeting federal requirements.

In formalizing its accounting mechanism, the District retroactively – back to 1990 – reduced the 1.2 to 1.0 offset ratio to a 1.0 to 1.0 offset ratio for three pollutants for which the District has not been designated extreme nonattainment. These are particulate matter less than 10 microns (PM10), oxides of sulfur (SOx) and carbon monoxide (CO). It then credited the remaining 0.2 offset credit to the Priority Reserve account. You imply that this is a reduction of the District's offset requirement that reduces the stringency of the District's NSR rule. You also assert that the 0.2 offset credit has already been credited to the District's required air quality advancements under its State Implementation Plan (SIP) and is no longer surplus whether or not it was creditable 16 years ago.

The new rule also credited the Priority Reserve with offsets from unclaimed emission reductions due to minor source shutdowns occurring since 1990. You assert that this action "substantively shifts from an existing NSR program that advances air quality goals by applying the benefit of minor source shut downs to air quality improvements, to a practice of forgoing these benefits." (Petition at 5).

Rule 1309.1, Priority Reserve. Under this rule as it existed on December 30, 2002, only power plants that completed applications to the California Energy Commission in 2000-2003 had access to the District's Priority Reserve. The District's amendments allow specific electrical generation facilities and energy projects of regional significance to qualify for SOx, PM10, and CO Priority Reserve credits when an applicant files a complete application for which credits are sought in calendar years 2005, 2006, 2007, and 2008 if certain criteria are met. In addition, the rule change allows electrical generation facilities located in a downwind air basin outside the South Coast Air Basin to draw volatile organic compound (VOC) credits from the Priority Reserve under specified conditions. You assert that "These changes violate SB 288 by allowing power plants access to below-market ERCs, altering the market structure established by SCAQMD's new source review rules and thereby weakening NSR protections." (Petition at 6.)

You also claim that the amendments to Rule 1309.1 present an aggregate rollback of the District's NSR program when viewed in combination with new Rule 1315. This is because Priority Reserve credits made available to power plants in 2000-2003 were not generated by minor source shutdowns or additional offset reductions, but such credits will be included in the Priority Reserve for power plants applying to CEC in 2005-2008.

You further assert that, taken together, the District's actions eliminate the District requirement for an additional 0.2 offset that accrues to the benefit of air quality. While power plants still must purchase the additional offset from the Priority Reserve, the District "re-captures the additional .2 offset and generates entirely new credits, credits that may be given to power plants (or other sources) again." You believe this means that, "from an air quality perspective, power plants will actually be operating at an offset ratio of 1-to-1, not 1.2-to-1." (Petition at 6).

The Requirements of SB 288

The key SB 288 restrictions on districts amending their NSR rules are contained in the four subsections of HSC section 42504.

HSC section 42504(a) provides:

> No air quality management district or air pollution control district may amend or revise its new source review rules or regulations to be less stringent than those that existed on December 30, 2002. If the state board finds, after a public hearing, that a district's rules or regulations are not equivalent to or more stringent than the rules or regulations that existed on December 30, 2002, the state board shall promptly adopt for that district the rules or regulations that may be necessary to establish equivalency, consistent with subdivision (b).

This provision sets forth an overall equivalency requirement that allows a district to relax one NSR element only as long as one or more other elements are sufficiently strengthened to result in overall equivalent stringency. We interpret this broadly-worded provision to include offset requirements and to apply on a programmatic basis. For example, a district would not be allowed to relax NSR offset requirements if the overall effect of the district's amendments would render the NSR rules less stringent in the aggregate.

HSC section 42504(b) supplements this general prohibition against weakening NSR rules and regulations by delineating four elements which cannot be revised if the revisions would "exempt, relax, or reduce the obligations of a stationary source. . . . " These elements are listed in Section 42504(b)(1):

> (A) The applicability determination for new source review.
>
> (B) The definition of modification, major modification, routine maintenance, or repair or replacement.
>
> (C) The calculation methodology, thresholds or other procedures of new source review.
>
> (D) Any definitions or requirements of the new source review regulations.

HSC section 42504(b)(2) provides that the rule components listed above may not be amended if doing so would "exempt, relax, or reduce the obligations of a source" with regard to the following requirements:

> (A) Any requirements to obtain new source review or other permits to construct, prior to commencement of construction.
>
> (B) Any requirements for best available control technology (BACT).
>
> (C) Any requirements for air quality impact analysis.

> (D) Any requirements for recordkeeping, monitoring and reporting in a manner that would make recordkeeping, monitoring, or reporting less representative, enforceable, or publicly accessible.
>
> (E) Any requirements for regulating any air pollutant covered by the new source review rules and regulations.
>
> (F) Any requirements for public participation, including a public comment period, public notification, public hearing, or other opportunities or forms of public participation, prior to issuance of permits to construct.

HSC section 42504(c) provides:

> In amending or revising its new source review rules or regulations, a district may change any of the items in paragraph (1) of subdivision (b) only if the change is more stringent than the new source review rules or regulations that existed on December 30, 2002.

Finally, notwithstanding the general anti-backsliding provision set forth in HSC section 42504(a) and the source-specific prohibitions set forth in HSC section 42504(b), the Act allows revisions that may result in less stringent district NSR rules under the carefully circumscribed circumstances described in HSC section 42504(d). The rule amendment must be accomplished at a public hearing based upon substantial evidence in the record and the district must submit the amendment(s) to the ARB for approval at a public hearing in order to ensure that the several conditions for such rule revisions have been met. Since the SCAQMD has not attempted to invoke HSC section 42504(d) with respect to the amendments covered by your Petition, I do not list the conditions here.

Applying SB 288 to the Challenged District Actions

Since the challenged District actions do not pertain to any of the requirements listed in HSC section 42504(b)(2), we have evaluated them under the equivalency requirements of HSC section 42504(a). You assert that new Rule 1315 is subject to the more rigid prohibitions in HSC section 42504(b) "because it regulates NSR air pollutants" (Petition at 5). But the reference in HSC section 42504(b)(2)(E) to "Any requirements for regulating any air pollutant covered by the new source review rules and regulations" was intended to cover amendments removing pollutants from NSR requirements. Construing it so broadly that it includes any requirement that pertains to any pollutant subject to NSR would make the listing of the other five requirements in HSC section 42504(b)(2) meaningless.

Rule 1315, New Source Review Tracking System

Rule 1315 is a new rule; no prior version existed on December 30, 2002. The rule does not change the quantity of offsets that any source must supply (1.2 to 1.0 for emission increases). Rather, it allows two streams of previously uncredited reductions to fund the District's internal ERC accounts. First, the 20 percent difference since 1990 between the amount of offsets federally required in accordance with the one to one offset ratio, and the amount of offsets the District required through the 1.2 to 1.0 ratio. Second, surplus emission reductions from minor source shutdowns not previously accounted for were placed into the District's internal credit bank. State law does not specify an offset ratio. Rather, the District must ensure that its stationary source program will achieve "no net increase" in emissions from new and modified sources of nonattainment pollutants or their precursors.

Contrary to your assertions, the emissions difference in offset ratios between federal requirements and what the District has required (20 percent) was not claimed in the SIP to demonstrate progress towards attainment of the NAAQS. Nor was the emission inventory, which determines the amount of emission reductions that are necessary for attainment of the NAAQS, reduced by the 20% difference in offset amounts. Thus, measures that are included in the SIP are intended to reduce this portion of emissions from new and modified major sources, even though they have already been offset. Moreover, the trade ratios for sources using ERCs from the Priority Reserve account have not changed. As a result, adoption of this rule results in a two-fold benefit: formally requiring a 1.2 to 1.0 offset trade ratio that goes beyond the requirements of federal and state law, and using funds received from Priority Reserve purchases for additional emission control projects where the emissions are generated. We find nothing in SB 288 that would prohibit the District from taking advantage of these valid reductions.

Similarly, emissions reductions from minor source shutdowns were not claimed as SIP measures, nor were the reductions from shutdowns used to reduce the emissions inventory. The emissions from these sources were included in the emissions inventory for the South Coast Air Basin and constitute a small portion of the aggregate emissions that must be reduced to achieve attainment of the ambient standards. The fact that shutdown sources are no longer emitting pollutants means that their emissions have in effect been "double counted," i.e. controlled twice: once through SIP control measures and again by their closure. We find nothing in SB 288 that would prohibit the District from taking advantage of any validly documented and quantified shutdown reductions and crediting these emission reductions in its internal Priority Reserve account.

The fact that this procedure for crediting shutdowns did not exist in District rules on December 30, 2002 does not establish that it is a revision that renders the rules less stringent than they were on the earlier date, in violation of Health and Safety Code section 42504(a). We understand that many tons of ERCs that were previously in the District's internal accounts were retired during this revision process. You have not demonstrated in your Petition that the adoption of the new tracking procedure, in the aggregate, has weakened the District's NSR rules. Moreover, the offset obligations of all sources remain the same and the revenues from purchase of these credits are used to fund emission control projects in the District. We believe that in the aggregate the District's NSR rules are equivalent to those in effect on December 30, 2002.

Rule 1309.1, Priority Reserve

Rule 1309.1 is an existing rule governing the District's Priority Reserve account which specifies that essential public services may access and purchase ERCs from the District. The amendments to Rule 1309.1 provide access to these ERCs for power plants both within and outside of the South Coast Air Basin. These sources must still supply the same quantity of offsets for new and modified facilities as they did before, although the availability of ERCs is more assured and the cost may be less. Again, we find nothing in SB 288 that requires the District to maintain the same parameters for its ERC accounts as it existed on December 30, 2002. The statute does not lock the District or stationary sources into an inequitable price for ERCs or means of obtaining them.

Although you claim that the amendments to Rule 1309.1, in conjunction with the increased availability of offsets due to the adoption of Rule 1315, increase emissions, and results in a 1:1 offset ratio for power plants, this claim fails for the same reason as your argument regarding Rule 1315. The new rule does not "cheat the air" of any emission reductions, because these emissions were included within the aggregate emissions that the SIP had to reduce in order to demonstrate attainment. While one can argue that using any surplus emission reductions to offset new source growth "converts air quality benefits into rights to pollute" (Petition at 5), the Legislature chose to strike a balance that would allow economic growth while not jeopardizing air quality by means of offsets and banking.

It is not the purpose of SB 288 to prohibit the banking and use of otherwise legitimate ERCs. Both of the District's challenged actions are consistent with the Legislature's stated purpose in enacting SB 288: they do not jeopardize attainment of state and federal air quality standards; they ensure that economic growth occurs in a manner consistent with preserving air quality; and they ensure that emissions from any source do not interfere with any portion of the State Implementation Plan (see HSC

section 42503). If your argument were followed to its logical conclusion, any procedure or methodology that facilitated the use of credits that were dormant (either in the District accounts, but not yet used, or simply "in the air") would be an impermissible weakening of the District's NSR rules or regulations. We do not believe SB 288 requires or authorizes this result.

Conclusion

For the reasons set forth above, I have concluded that – as a matter of law – the District's September 8, 2006 adoption of Rule 1315 and amendments to Rule 1309.1 do not cause the District's NSR rule to be less stringent than the rule was on December 30, 2002. Consequently, should a public hearing before our Board occur on this matter, based on the information now before me I would advise the Board of my legal opinion that the District's actions do not constitute a violation of SB 288.

Notwithstanding my conclusions, we are prepared in this particular instance to schedule a hearing by the full ARB Governing Board on your Petition if you so desire. Please let us know if you want to pursue that course of action. In the meantime, if you have any questions about our legal analysis, please contact me at (916) 323-9606 or Ms. Leslie Krinsk, Senior Staff Counsel at (805) 473-7325. For technical questions about the District's NSR rule, please contact Mr. Chris Gallenstein, Staff Air Pollution Specialist in the Stationary Source Division at 916) 324-8017.

Sincerely,

/s/

W. Thomas Jennings
Chief Counsel

cc: See next page.

cc: Ms. Barbara Baird
District Counsel
South Coast Air Quality Management District
21865 East Copley Drive
Diamond Bar, California 91765-4182

Ms. Ann Lyons
Attorney-Advisor
U.S. Environmental Protection Agency
75 Hawthorne Street, *Mail Code:* ORC-2
San Francisco, California 94105

Ms. Ellen Peter
Supervising Deputy Attorney General
California Attorney Generals Office
1300 I Street
Sacramento, California 95814

Dr. Barry Wallerstein
Executive Officer
South Coast Air Quality Management District
21865 East Copley Drive
Diamond Bar, California 91765-4182

Ms. Laura Yannayon
U.S. Environmental Protection Agency
75 Hawthorne Street, *Mail Code: Air-3*
San Francisco, California 94105

Robert F. Sawyer, Ph.D.
Chair

Honorable Board Members